
AUDIT REPORT



REVIEW OF THE JOINT EMPOWERMENT ZONE PROGRAM OF THE CITIES OF NORFOLK AND PORTSMOUTH, VIRGINIA

2003-PH-1001

DECEMBER 20, 2002

OFFICE OF AUDIT, MID-ATLANTIC DISTRICT
PHILADELPHIA, PENNSYLVANIA



Issue Date

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Audit Case Number

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TO: Pamela Glekas Spring, Director, Renewal Communities/Empowerment Zones/Enterprise Communities, DZ

FROM: Daniel G. Temme, Regional Inspector General for Audit, Mid-Atlantic, 3AGA

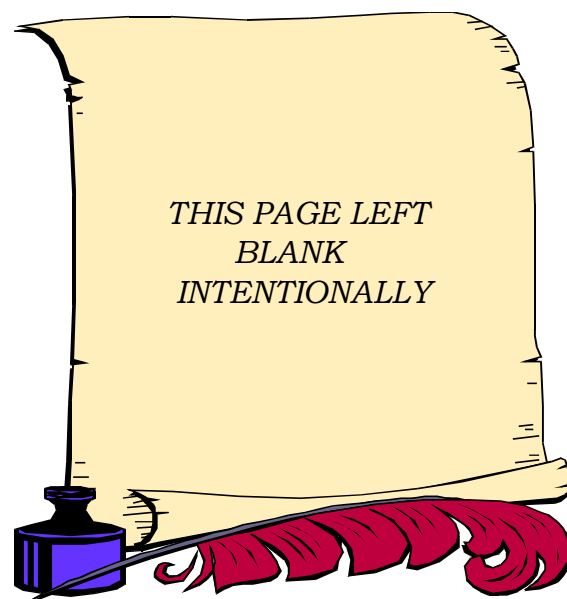
SUBJECT: City of Norfolk
Empowerment Zone Program
Norfolk, VA

We completed an audit of the City of Norfolk/Portsmouth Empowerment Zone Program. The audit was conducted based upon a request from Congress. The Objectives of our audit were to determine whether the City: (1) efficiently and effectively used Empowerment Zone funds to meet the objectives of its Strategic Plan; and (2) accurately reported the accomplishments of its Empowerment Zone Program to HUD.

Our report contains two findings with recommendations requiring action by your office. The two findings address recommendations to strengthen the City's administration over the Program to ensure funds are used more effectively and efficiently. Specifically, the City needs to strengthen its controls in disbursing Empowerment Zone Program funds and improve the process of reporting the accomplishments of its Program to HUD.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days please provide us, for each recommendation without a management decision, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact John Buck, Assistant Regional Inspector General for Audit, at (215) 656-3401 extension 3486.



Executive Summary


We completed an audit of the joint Empowerment Zone Program of the Cities of Norfolk and Portsmouth, Virginia. This audit was part of our national review of the use of Empowerment Zone funds.

The House of Representatives Conference Report 107-272 directed HUD's Office of Inspector General to review the use of Empowerment Zone funds and to report our findings to the Senate Appropriations Committee. The United States Senate's Report 107-43 also requested HUD's Office of Inspector General to review the use of Empowerment Zone funds with a report to Congress. To accomplish this task, HUD's Office of Inspector General completed a survey review of HUD's Empowerment Zone Program and identified seven Empowerment Zones to audit. The seven Empowerment Zones were located in the following localities:

- Cincinnati, Ohio;
- Cleveland, Ohio;
- Cumberland County, New Jersey;
- Huntington, West Virginia/Ironton, Ohio;
- Minneapolis, Minnesota;
- Norfolk/Portsmouth, Virginia; and
- St. Louis, Missouri/East St. Louis, Illinois.

The objectives of this audit were to determine whether the Cities of Norfolk and Portsmouth (City): (1) efficiently and effectively used Empowerment Zone funds; and (2) accurately reported the accomplishments of its Empowerment Zone Program to HUD. The audit was part of our fiscal year 2002 Annual Audit Plan.

We concluded that the City generally maintained adequate oversight over its Empowerment Zone funds. However, we did identify a number of areas where the City needs to strengthen its administration over the Program to ensure funds are used more effectively and efficiently. Specifically, we found the City did not maintain adequate controls over about 7.25-percent of the \$8.9 million of disbursements we reviewed and did not always accurately report the accomplishments of its Empowerment Zone Program to HUD. We also found that 85-percent of the current staff of Empowerment 2010, Incorporated was not hired until the third year of designation (June through December 2001). In our opinion, this initial lack of staffing contributed significantly to the initial slow progress the City made in implementing the strategic plan as well as other problems identified in this report. The results of our review are summarized below and detailed in the Finding section of this report.



City Needs To Ensure
Funds Are Used
According To Approved
Implementation Plans

Our review of eighteen funded Empowerment Zone activities (Appendix B) showed that the City did not maintain adequate control over the funds for seven activities. This accounted for \$643,446 of the \$8.9 million disbursements (7.25-percent) we reviewed. Specifically, we found the City obtained \$293,772

from HUD for activities without approved implementation plans and paid \$100,332 for items or services that were either unallowable or unsupported. The City took immediate corrective action and obtained the required HUD approved implementation plan for \$61,950 of the \$293,772 after we informed them of the issue. Officials also did not properly allocate indirect costs totaling \$249,342 among activities benefiting from the funding. These deficiencies occurred because responsible officials did not establish policy or procedures to ensure funds would be used according to approved implementation plans or to ensure they maintained an indirect cost allocation plan for allocating costs that benefited several activities. Officials also did not maintain and use Federal cost guidelines to ensure costs met Federal requirements. Consequently, Empowerment Zone funds were not always used in the most efficient and effective way to meet the objectives of the strategic plan and in accordance with Federal requirements.

City Inaccurately Reported Activity Accomplishments To HUD

We found the City inaccurately reported milestones, outputs and leveraged funding accomplishments for its Round II Empowerment Zone activities in its 2001 Annual Progress Report to HUD. Specifically, the City inaccurately reported: (1) 28 of 54 performance milestones for all six activities; (2) 14 of 34 of the outputs related to four of the six activities; and (3) leveraged funding of \$6.5 million that was not supported. These inaccuracies occurred because the nonprofit organization created to manage the Empowerment Zone Program (Empowerment 2010, Incorporated) did not: (1) develop and maintain a formal reporting policy that staff could consistently apply to ensure correct reporting of the Zone's accomplishments to HUD; (2) develop and maintain a centralized database system to ensure complete information was readily available; (3) verify the accuracy of the information reported in the Annual Report; and (4) have adequate staff for updating the status of the activities. Consequently, the impression exists that the Empowerment Zone has accomplished more than what it actually had under the Annual Progress Report to HUD.

Recommendations

We recommended HUD's Director of Renewal Communities/Empowerment Zones/Enterprise Communities Initiative require the City to submit separate implementation plans for each activity to HUD for review and approval. We also recommended HUD require the City

Auditee Comments

to reimburse the Program \$100,332 for material and services that were unsupported or not allowed under the Federal Cost guidelines. Lastly, we recommended specific controls to help the City more effectively allocate its indirect costs and improve its reporting process.

We presented our draft findings to the Executive Director of the City's Empowerment Zone Program and HUD's staff during the audit. We held an exit conference with the Executive Director of the Empowerment 2010, Incorporated on December 5, 2002. The City provided written comments to our draft findings on December 16, 2002.

Generally, the City concurred with our findings and recommendations to improve its oversight over Empowerment Zone funds and reporting the Program's accomplishments to HUD. However, the City disagreed with some of our questioned costs and provided additional documentation after our exit conference to support these costs. We reviewed the additional documentation and adjusted the report as necessary. The City's comments and our evaluation of their comments are summarized at the end of each of the two findings in this report. The complete text of the City's comments is included as Appendix D.

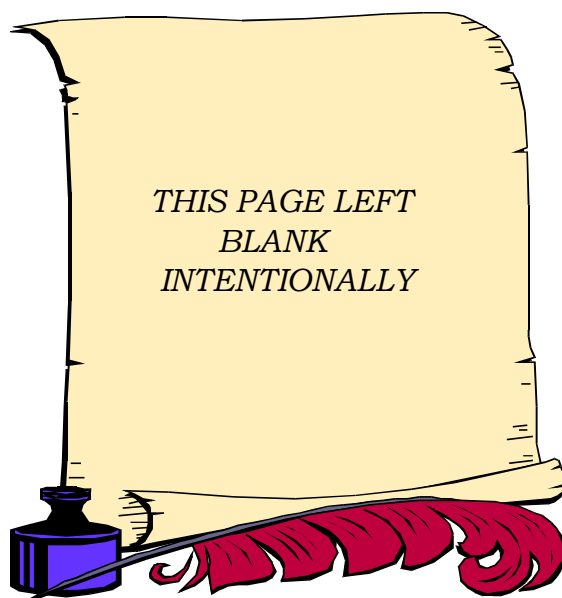


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Abbreviations

CFR	Code of Federal Regulations
EZ	Empowerment Zone
HUD	U. S. Department of Housing and Urban Development
OMB	Office of Management and Budget

Introduction

The City of Norfolk, along with the City of Portsmouth was jointly designated as an urban Empowerment Zone effective January 1, 1999. The objective of the Empowerment Zone Program is to rebuild communities in poverty stricken inner cities and rural areas by developing and implementing strategic plans. Strategic plans must to be based upon the following four principles: (1) creating economic opportunity for Empowerment Zone residents; (2) creating sustainable community development; (3) building broad participation among community-based partners; and (4) describing a strategic vision for change in the community.

The Omnibus Budget Reconciliation Act of 1993 authorized the Empowerment Zone Program. The Reconciliation Act provided funding for the Empowerment Zone Program under Title 20 of the Social Security Act. The Program was designed to provide \$250 million in tax benefits with \$100 million of Social Service Block Grant funds from the Department of Health and Human Services. The Taxpayer Relief Act of 1997 authorized the Secretary of HUD to designate 15 additional urban areas as Empowerment Zones. Round II Empowerment Zones were eligible to share in Federal grants and tax-exempt bonding authority to finance revitalization and job creation over the next ten years.

The City of Norfolk, the lead city for the Empowerment Zone, is a municipal corporation governed by a mayor and a city council. The current Mayor is the Honorable Paul D. Fraim. Empowerment 2010, Incorporated administers its Empowerment Zone program and a Board of Directors manages the affairs of the Corporation. The current Chairman of the Board is Mr. Lee E King. The Corporation's current Executive Director is Dr. Landis Faulcon. The Corporation's fiscal year is January 1 through December 31. Copies of the Corporation's books and records are located at 3rd floor, 2539 Corprew Ave. Norfolk, Virginia.

Audit Objectives

The objectives of our audit were to determine whether the City: (1) efficiently and effectively used Empowerment Zone funds; and (2) accurately reported the accomplishments of its Empowerment Zone Program to HUD.

Audit Scope and Methodology

We performed our on-site work between July and October 2002. To determine whether the City efficiently and effectively used Empowerment Zone funds, we non-statistically selected 18 activities that received the most funding for review. For the 18 highest funded activities we reviewed \$8.9 million of the \$10.8 million total disbursement as of June 30, 2002. To determine whether the City accurately reported the accomplishments of its Empowerment Zone Program, we reviewed all six activities reported in the June 2001 Annual Report. Overall, we

reviewed 21 activities. We interviewed staff from HUD, the City, and administering entities of the City's Empowerment Zone activities. The following table shows the 21 Empowerment Zone activities:

<i>Empowerment Zone Activity</i>
1. Formation And Administration Of E-2010 Corporation
2. Mobile Empowerment Center
3. Empowerment Center/Portsmouth *
4. Empowerment 2010 Works
5. Access To Jobs
6. College Bound Scholarship
7. Child Care Programs
8. Second Chances Program
9. Training Stipends
10. MEDAL Loan Loss Reserve
11. Small Business Resource Center
12. Tower Mall
13. Park Place East
14. Central Brambleton
15. New Electrical Substation In Support Of HOPE VI
16. Anne/Outten Street Development
17. Brewery Site Development
18. Norfolk EZ/HOPE VI Community And Support Services
19. Neighborhood Development *
20. Administrative Office And Empowerment Center/Norfolk
21. Tuition Voucher Fund *
* Activity's disbursements not reviewed

To evaluate the City's Empowerment Zone Program, we reviewed records maintained by HUD, the Empowerment 2010, Inc., and the administering entities. We reviewed: HUD's guidance and instructions for the Program; the City's June 2001 Annual Report, files, reports, and approved payment requests related to the activities; and the administering entities' voucher payments, monitoring files, and supporting documentation.

The audit covered the period January 1, 1999 to June 30, 2002. This period was adjusted as necessary. We conducted our audit in accordance with generally accepted government auditing standards.

The City Did Not Always Maintain Adequate Control Over Its Empowerment Zone Funds

The City did not always maintain adequate control over its Empowerment Zone funds. Our review of eighteen of the highest funded Empowerment Zone activities (Appendix B) showed that the City did not maintain adequate control over funds for seven activities, which accounted for \$643,446 of the \$8.9 million disbursements (7.25-percent) we reviewed. Specifically, we found the City:

- Obtained \$293,772 from HUD for two activities that did not have HUD approved implementation plans, and one activity outside the scope of its plan.
- Paid \$100,332 for items or services that were either unallowable or unsupported.
- Did not properly allocate indirect costs totaling \$249,342 among activities that benefited from the costs related to the goods or services.

The deficiencies occurred because Empowerment 2010, Incorporated, which the City contracted with to administer its Empowerment Zone program, did not: (1) establish and maintain formal policy and procedures to ensure funds would be awarded and used according to requirements; (2) establish and maintain an indirect cost allocation plan for allocating costs that benefit several activities; and (3) maintain and use federal cost guidelines to ensure cost of the activities met the Federal requirements. As a result, Empowerment Zone funds were not always used in the most efficient and effective manner to meet the objectives of the strategic plan and in accordance with Federal requirements.

Criteria

Federal regulations [24 CFR 85.30 (c)] require grantees to obtain the prior approval of HUD for any revisions to their approved plans resulting in the need for additional funding.

OMB Circular A-87, Attachment A, Section C (1) states that costs are allowable under Federal awards if the costs are: 1) necessary and reasonable for proper and efficient performance and administration of Federal awards; 2) allocable to a particular award; and 3) adequately documented.

OMB Circular A-87, Attachment A, Section C (3) states that a cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to

such cost objective in accordance with the benefits received. All activities that benefit from the governmental units indirect costs including unallowable activities and services donated to the governmental unit by third parties, will receive an appropriate allocation of indirect costs.

OMB Circular A-87, Attachment B, Section 2(e)(3), provides that costs of promotional items and memorabilia, including models, gifts, and souvenirs, are unallowable.

OMB Circular A-87, Attachment B, Section 13, provides that Contributions and donations, including cash, property, and services, by governmental units to others, regardless of the recipients, are unallowable.

The Memorandum Of Agreement, paragraph 3, between HUD and the City states that the City shall comply with all the elements of the HUD approved application for designation, including the strategic plan, and all assurances, certifications or other submissions made in support thereof, all implementation plans, milestones, baselines, activities, schedules that are attached hereto and incorporated into this agreement, and all subsequent submissions approved by the parties to this agreement.

Grant Agreement, Article I (A) and (D) between HUD and the City requires the City to use grant funds only for activities necessary to implement the strategic plan, to the extent it complies with the administrative requirements of 24 CFR Part 85, including the procurement requirements of 24 CFR Part 85.36, and the requirements of OMB Circular A-87 regarding Cost Principles for State and Local Governments.

City Obtained Zone Funds
Without HUD Approved
Implementation Plans

The City obtained \$293,772 of Empowerment Zone funds for three activities even though the activities did not have HUD approved implementation plans. Empowerment 2010, Incorporated used the Empowerment 2010 Works implementation plan to draw down funds in support of all workforce development activities. But, HUD requires each Empowerment Zone to create an Implementation Plan in its automated Performance Measurement System for each activity the Zone undertakes. Federal regulations [24 CFR 85.30 (c)] also require grantees to obtain the prior approval of HUD for any revisions to their approved plans resulting

in the need for additional funding. These are essential requirements because they allow HUD to properly monitor programs and ensure that funds are used only for approved Zone activities. To ensure that these requirements are met, HUD requires responsible Empowerment Zone officials to certify prior to receiving grant funds that:

- The Empowerment Zone Governing Board has approved funding for each of the implementation plans.
- HUD has approved each implementation plan.
- Requested funds will be used only in conjunction with eligible economic development activities consistent with the strategic plan of the Empowerment Zone.
- Each budget line item on the voucher will only be used with the implementation plan shown on the voucher for all drawdowns.

Our audit showed however that Empowerment Zone officials made the above certifications and obtained \$231,822 for two program activities (Childcare and Second Chances Programs) without HUD approved implementation plans. Additionally, officials made the above certifications and received funding for another activity (Empowerment 2010 Small Business Resource Center) that was \$61,950 greater than the funding in their HUD approved implementation plan. Details of each activity are discussed below.

Childcare Program. This activity was identified in the strategic plan as part of the Employment Support Services Program scheduled to be implemented in the first two-years of the Empowerment Zone designation. The program is expected to enhance the delivery of daycare programs to provide more affordable daycare to low-income working families. The Governance Board approved a four-year budget for this activity in the amount of \$316,166. However, contrary to HUD requirements, responsible Empowerment Zone officials did not submit an implementation plan to HUD for this activity, and as of June 2002, officials expended \$176,977 of Empowerment Zone funding for this activity without an approved implementation plan.

Second Chances Program. This activity was identified in the strategic plan as part of the Adult Workforce development program to be implemented for year three to year ten of the City's Empowerment Zone designation. The program is expected to provide employment opportunities and comprehensive services to ex-offenders. The Governance Board approved a four-year budget for this activity totaling \$153,000. However, responsible Empowerment Zone officials did not submit an implementation plan to HUD for this activity. As of June 2002, officials expended \$54,845 of Zone funds for this activity without an approved implementation plan.

Small Business Resource Center. This activity is expected to provide access to capital and technical assistance to businesses and result in the creation of jobs for Zone residents. As of June 2002, the HUD approved implementation plan for this activity totaled \$363,000. However, our review of the Empowerment 2010 financial records showed that Empowerment Zone officials had already spent \$424,950 or \$61,950 over the HUD approved budget and implementation plan.

Responsible Empowerment Zone officials of Empowerment 2010, Incorporated told us they used the Empowerment 2010 Works implementation plan to provide the vehicle necessary to draw down funds in support of all workforce development activities, which included two of these three activities (Childcare and Second Chances Programs). Further, they stated the absence of separate implementation plans for the activities did not mean that funds were used inappropriately. Although we found that these activities were described in general terms in the Strategic Plan they did not have supporting implementation plans. HUD requires each Empowerment Zone to create an Implementation Plan and Federal regulations also require grantees to obtain the prior approval of HUD for any revisions resulting in the need for more funding.

Since responsible officials did not create implementation plans according to HUD requirements, they could not properly monitor their progress toward meeting projected outputs and milestones for these activities nor could they assure the funds were used properly. After we discussed this issue with responsible officials, they acknowledged the need

for separate implementation plans for the Childcare and Second Chances Programs and agreed to submit these plans to HUD for review and approval. For the Empowerment 2010 Small Business Resource Center Empowerment Zone, officials took immediate corrective action and obtained the required HUD implementation plan on December 4, 2002 that included the \$61,950 expended above the previous HUD approved budget.

City Sometimes Paid
Unallowable and/or
Unsupported Costs

We reviewed \$8.9 million of the \$10.8 million disbursed by the Empowerment Zone as of June 2002, and identified \$100,332 for items or services that were unallowable or unsupported. Specifically, the City paid unallowable costs totaling \$26,291 (\$20,285 for food and \$6,006 for gifts and memorabilia) related to four Empowerment Zone activities and could not provide adequate support for another \$74,041 in costs.

OMB Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments, states that to be allowable under Federal awards, costs must be necessary and reasonable for proper and efficient performance and administration of federal awards. The question of reasonableness is particularly important when governmental units or components are predominately federally funded. A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. The OMB circular states that costs of promotional items and memorabilia, including models, gifts, and souvenirs, are unallowable. It also states that entertainment costs such as meals or lodging are unallowable. The following table shows Empowerment Zone Activities that incurred some costs that were unallowable or unsupported.

Activity	Unallowable Costs	Unsupported Costs
Empowerment 2010 Works	\$ 6,533	\$ -
Formation and Administration Of Empowerment 2010 Corporation	\$ 18,052	\$ 34,041
Administrative Office and Empowerment Center/Norfolk	\$ 293	\$ 25,000
Empowerment 2010 Small Business Resource Center Norfolk EZ/ HOPE VI Community and Supportive Services	\$ 1,413	-
TOTAL	\$ 26,291	\$ 74,041

Empowerment 2010 Works. This activity is expected to assist Zone residents in achieving higher incomes and increased employment. Officials disbursed \$2.7 million for this activity as of June 2002. We reviewed \$1.98 million in disbursements for this activity and found officials paid related costs of \$6,533 that were not allowable or could not be supported. Officials paid for the costs of meals, food, and promotional materials such as banners, T-shirts, and gifts that totaled \$6,533 (\$5,312 for food and \$1,221 for memorabilia). These costs were not necessary and reasonable because it is not clear how they help achieve the objective of this activity, which is self-sufficiency for the Empowerment Zone residents.

Formation and Administration of Empowerment 2010 Corporation. The Empowerment 2010 Corporation was formed to provide effective administration of the Empowerment Zone for the Cities of Norfolk and Portsmouth. As of June 30, 2002 officials disbursed \$1.2 million for this activity. We reviewed \$568,457 of these disbursements and found officials paid costs of \$52,093 that were not reasonable, necessary or could not be supported. Officials paid for the costs of meals, food, and promotional materials such as banners, T-shirts, and gifts that totaled \$18,052 (\$13,327 for food and \$4,725 for memorabilia). Also, responsible officials could not support disbursements of \$34,041. Specifically, they paid \$34,041 for financial consulting services but could not provide adequate invoices or appropriate Financial Services Agreements to fully support the costs. In our opinion these costs were not necessary and reasonable because it was unclear how they helped achieve the objective of this activity, which is effective administration of the Empowerment Zone for the Cities of Norfolk and Portsmouth.

Administrative Office And Empowerment Center/Norfolk. This activity is expected to increase the availability and access of essential services for empowering individuals, families and communities. As of June 2002, officials disbursed \$287,492 for this activity. We reviewed \$190,801 in disbursements for this activity and found officials paid costs of \$25,293 that were unallowable or could not be supported. Specifically, we found that the City paid \$25,000 to a property owner to renovate the office

space for the Empowerment 2010 administrative offices in Norfolk in exchange for a lower monthly rent. But, the City could not provide adequate documentation to support the claim that they received a lower monthly rent. The City also charged this activity \$293 for unallowable costs of meals.

Empowerment 2010 Small Business Resource Center.

This activity is expected to provide access to capital and technical assistance to businesses and result in the creation of jobs for Zone residents. As of June 2002, officials disbursed \$424,950 for this activity. We reviewed \$171,028 of these disbursements and found officials paid unallowable/ineligible costs for meals, food, and promotional materials such as banners, T-shirts, and gifts that totaled \$1,413 (\$1,353 for food and \$60 for memorabilia).

Norfolk Empowerment Zone/HOPE VI Community And Supportive Services.

This activity will provide community services that are expected to result in benefits such as increases in the number of people who earn a high school diploma or who achieve computer literacy. As of June 2002, officials disbursed \$112,427 for this activity. We reviewed \$105,687 of the disbursements for this activity and found officials paid costs of \$15,000 that were not supported. Specifically, we found that the City paid \$15,000 to a property owner to renovate office space in Norfolk that was used by the activity, but the City could not provide adequate documentation to support the claim that they received a lower monthly rent.

Responsible personnel from Empowerment 2010, Incorporated told us that providing meals, food, and gifts, was one of the costs for doing business in the Norfolk/Portsmouth Empowerment Zone. They said these were necessary expenditures for recognizing the contributions of citizen and business volunteers participating in Governance Board, Citizens Advisory Board, and Community meetings in the Empowerment Zones. Officials also stated that OMB Circular A-87 allows them to pay for meals from federal funds as long as it is not classified as an entertainment expense.

City Needs To Develop
And Implement An
Indirect Cost Allocation
Plan

Under limited instances the cost of meals may be allowable under OMB Circular A-87. This only applies to meals provided at meetings where the primary purpose is the dissemination of technical information. However, we found catered food was provided at meetings where the primary purpose was not the dissemination of technical information. Further, as we noted, officials spent \$26,291 (\$20,285 food and \$6,006 memorabilia) over an 18-month period for food, gifts and catered meals for their meetings and events. On average this is about \$1,461 per month for food, beverages and gifts. Over the course of the ten-year Empowerment Zone designation this could amount to over \$175,000. Although we agree it is important to recognize volunteers for their services, we question the need to spend \$1,461 per month for food, meals, gifts and promotional items to do so.

The City did not properly allocate indirect costs totaling \$249,342 among the different Empowerment Zone activities that benefited from them. These costs were associated with financial, information technology, and personnel services which all activities benefited from and should have been charged a fair share of the costs.

As we stated previously, OMB Circular A-87, Attachment A, Section C (3) requires that a cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with the benefits received. All activities that benefit from the governmental units indirect costs, including unallowable activities and services donated to the governmental unit by third parties, will receive an appropriate allocation of indirect costs.

We found that the City charged costs totaling \$193,030 to one activity (Formation and Administration of the Empowerment 2010 Corporation) that should have been allocated among all of the Zone's activities. Since the costs were associated with providing financial, information technology, and personnel services that benefited all the activities, each activity should have been charged a fair share of the costs. Likewise, officials charged facility rental costs to another activity totaling \$56,312 (Norfolk Administrative Office and Empowerment Center) that should have been proportionally distributed to two other activities (Formation and Administration of the

Empowerment 2010 Corporation and Norfolk Empowerment Zone/HOPE VI Community And Supportive Services). In order to properly manage the Empowerment Zone funding, officials need to ensure that costs are properly allocated among all of the activities that benefit from them.

After we discussed this issue with Empowerment 2010 officials, they acknowledged the need to establish and use an indirect cost allocation plan to better distribute costs for each activity benefited from the services.

Auditee Comments

The City agreed to develop and use an indirect cost plan to allocate indirect costs and to cease paying for the costs of meals, gifts and contributions specifically prohibited by OMB Circular A-87. The City reiterated that it used its HUD approved Empowerment 2010 Works Implementation Plan to draw down funds in support of all workforce development activities but did agree to submit separate implementation plans for the two questioned activities. The City also agreed the costs of memorabilia were unallowable but contended that most of the meals it paid for with federal funds were allowable under Attachment B, Section 30 (c) of OMB Circular A-87. The City asserted the costs of meetings and conferences where the primary purpose is the dissemination of technical information, including meals are allowable under this provision. Lastly, the City provided additional documentation after our exit conference to support costs we categorized as unsupported.

OIG Evaluation of Auditee Comments

We are encouraged that the City has agreed to take needed corrective actions on most of our recommendations. In regard to the meals expense, our audit showed that the meals expenses are unallowable. While some technical information may have been provided at the meetings and events where meals were routinely provided, our audit showed that this was not the primary purpose of many these meetings and events. Lastly, we reviewed the documentation provided by the City after the exit conference and made adjustments to our report when appropriate.

Recommendations

We recommend that HUD direct the City to:

- 1A. Submit separate implementation plans for the Child Care and the Second Chances Programs to HUD review and approval. If implementation plans are not submitted and, approved by HUD, then require the City to reimburse the Empowerment Zone Program \$231,822 from non-Federal funds for the amounts that cannot be supported.
- 1B. Reimburse the Empowerment Zone Program \$26,291 from non-Federal funds for unallowable costs paid for meals and gifts unless the City can provide additional documentation to resolve the cited deficiencies.
- 1C. Provide documentation to justify unsupported costs of \$74,041 paid from Formation and Administration Of Empowerment 2010 Corporation (\$34,041); Administrative Office and Empowerment Center/Norfolk (\$25,000); and Norfolk EZ/ HOPE VI Community and Supportive Services (\$15,000). If adequate documentation cannot be provided, require the City to reimburse from non-Federal funds the amounts that cannot be supported.
- 1D. Develop and use an indirect cost plan to allocate indirect cost and ensure that the \$249,372 costs our audit identified as not properly allocated are properly allocated.
- 1E. Cease paying for the costs of meals, gifts and contributions specifically prohibited by OMB Circular A-87.

The City Did Not Accurately Report The Accomplishments Of Its Empowerment Zone Activities to HUD

The City did not accurately report its progress in meeting performance milestones, outputs and leveraged funding for its Round II Empowerment Zone activities in its 2001 Annual Progress Report to HUD. Specifically, we found the City reported:

- 28 of 54 performance milestones inaccurately for all six activities. (The reported completion of 9 milestones was not supported and 19 planned completion dates were not updated).
- 14 of the 34 outputs for four of the six activities incorrectly or not at all.
- Leveraged funding of \$6.5 million that was not supported.

These inaccuracies occurred because the nonprofit organization created to manage the Empowerment Zone Program known as Empowerment 2010 did not: (1) develop and maintain a formal reporting policy that staff could consistently apply to ensure correct reporting of the Zone's accomplishments to HUD; (2) develop and maintain a centralized database system to ensure complete information was readily available; (3) verify the accuracy of the information reported in the Annual Report; and (4) have adequate staff for updating the status of the activities. As a result, the impression exists that the Empowerment Zone has accomplished more than what it actually had.

HUD Requirements

Federal regulations (24 CFR 598.415) require each designated Empowerment Zone to submit periodic reports to HUD. These reports must identify the community, local government and State actions that have been taken in accordance with the strategic plan. HUD has implemented the federal mandate by requiring Empowerment Zones to report activities and progress through the automated Performance Measurement System. HUD requires Empowerment Zones to submit implementation plans through the system for each activity undertaken. Additionally, HUD requires Zones to submit an Annual Report that includes information on funding sources and their progress toward meeting the projected outputs and milestones identified in each of their implementation plan. The measurement system defines outputs and milestone as follows:

- Outputs are the results immediately created upon implementation of a project or activity. Outputs are set when program or project are designed, and should clearly explain what quantifiable products are created by the project or activity.
- Milestones are the major steps taken by the Empowerment Zone and lead entities to implement the project or program. Milestone begins, in most cases, with the date the Empowerment Zone Board approved the project or activity and should also include monitoring and evaluation of the project.

City Incorrectly Reported
Empowerment Zone
Progress to HUD

The City incorrectly reported the actual status and/or the progress for all of the six Round II Empowerment Zone activities it reported to HUD in its 2001 Annual Progress Report. The following table shows overall reporting for each activity:

Activity	Total Milestones Reported	Milestones Not Supported	Milestone End-Date Not Updated	Total Outputs Reported	Outputs Reported Incorrectly or not Reported
Formation of Empowerment 2010 Corporation	16	2	9	3	3
Tuition Voucher Fund	5	1	4	6	3
Empowerment 2010 Works	8	2	3	9	4
Tower Mall	7	0	1	4	0
Small Business Resource Center and One Stop Capital Shop	9	4	0	5	0
New Electrical Substation In Support of HOPE VI	9	0	2	7	4
TOTALS	54	9	19	34	14

Reported Incorrect
Milestones

The City inaccurately reported key milestones for all six activities. We found that 28 of the 54 (52-percent) performance milestones were not reported accurately. As stated previously, milestones are the major steps taken by the Empowerment Zone and lead entities to implement the project or program. Milestone begins in most cases, with the date the Empowerment Zone Board approved the project or activity, and should also include monitoring and evaluation of the project. Details of our review of the milestones for the Empowerment Zone follow.

Formation of Empowerment 2010 Corporation. The formation of the Empowerment 2010 Corporation was an essential activity for effective administration of the Empowerment Zone for the cities of Norfolk and Portsmouth, but the City inaccurately reported 11 of 16 major milestones for this activity. The reported completion of two milestones was not supported and nine planned completion dates were not updated.

The milestones listed in the 2001 Annual Progress Report to HUD showed completion dates ranging from March to September of 2000, but the same report to HUD indicated most of the milestones were actually only 25 to 75-percent complete in June 2001. Also, two milestones (Evaluate the One Stop Capital Shop Program and Train Board Members) were listed as being 100-percent complete and Empowerment 2010 officials could not provide adequate documentation to support this claim.

Tuition Voucher Fund. This activity provides specific job training skills to residents and increases their job performance skills. We found the City did not accurately report on all five major milestones for this activity in its 2001 Annual Progress Report to HUD. The reported completion of one milestone was not supported and four planned completion dates were not updated.

Four of the five milestones were listed in the report with completion dates ranging from July to September of 2000. However, the same report showed the milestones were actually only zero to 25-percent complete in June 2001. Also, one milestone (Develop Request for Proposal for Service Providers) was listed as being 100-percent complete and Empowerment 2010 officials could not provide adequate documentation to support this claim.

Empowerment 2010 Works. The expected outcome for this activity is higher incomes and increased employment for Zone residents. The City inaccurately reported five of eight major milestones for this activity. The reported completion of two milestones was not supported and three planned completion dates were not updated.

Three milestones were listed in the 2001 Annual Progress Report to HUD with completion dates ranging from April to June of 2000. But, the same report to HUD showed the

milestones were actually only 25 to 50-percent complete in July 2000. Also, two milestone (Award Contracts, Monitor and Evaluate the Program) were listed as being 100-percent complete and Empowerment 2010 officials could not provide adequate documentation to support this claim. For example, we found that HUD was informed contracts were awarded in June 2000 when in fact the first contract had not been awarded until April 2001.

Tower Mall. The purpose of this activity is to redevelop an outdated mall into a retail power center that will provide retail services and employment opportunity for Zone residents. The City inaccurately reported one major milestone for this activity. The City reported the completion date for the former mall demolition as May 2001 in its 2001 Annual Progress Report to HUD. But, the same report indicated the milestone was actually only 75-percent completed in June 2001.

Small Business Resource Center and One Stop Capital Shop. This activity is expected to provide access to capital and technical assistance to businesses and result in the creation of jobs for Zone residents. For this activity the City inaccurately reported on four of nine major milestones. The four major milestones were listed as being 100-percent complete but Empowerment 2010 officials could not provide adequate documentation to support this claim. Officials reported that they:

- Had a Board approved business plan. Although officials provided us with copies of Board minutes to support this claim, the minutes only indicated approval of the lease for the center, not the business plan.
- Established a Memorandum of Understanding with the Small Business Administration on May 2001 when in fact they actually established it in July 2001.
- Hired a manager in May 2001 when in fact they had not done so until July 2001.
- Hired support staff in May 2001 when in fact they had not done so until August 2001.

New Electrical Substation In Support of HOPE VI. This activity will update and improve the electrical distribution infrastructure. An old outdated electrical substation on site is unattractive, unsafe and distributes power by overhead lines and needs to be replaced. The City inaccurately reported two of nine milestones for this activity. The City reported the scheduled Board approval for this activity as December 2003 in its 2001 Annual Progress Report to HUD. Yet, in the very same report to HUD they also reported Board approval as being 100-percent completed. Also, the City reported that it would install underground cable and remove overhead cable by August 2000 yet in the same report to HUD they also contradicted this by showing this milestone as being 50-percent completed.

Reported Incorrect Outputs for Activities

The City inaccurately reported Empowerment Zone outputs to HUD for four of the six activities. Overall, we found that 14 of the 34 outputs were reported inaccurately or not at all. As stated previously, outputs are the results immediately created upon implementation of a project or activity. Outputs are set when program or project are designed, and should clearly explain what quantifiable products are created by the project or activity. Results of our review follow.

Formation of Empowerment 2010 Corporation. The City could not provide adequate support for any of the three reported outputs for this activity. Officials reported that:

- Thirty-four Board members have been trained, but officials could not provide adequate support for this training. Officials did provide us with registration forms for twelve of the Board members for the White House Community Empowerment Conference held in Columbus, Ohio in June 2000. Also, they gave us a list of participants in a Governance Board retreat held in April 2000. However, no certificates of completion or training agendas were available and the documentation provided was not adequate to support that 34 Board members were properly trained.
- Twelve implementing agencies were trained, but officials could not provide certificates of completion, training agendas or other documentation that would support this claim.

- Sixty residents were trained. Officials gave us a list of 27 Citizens Advisory Board Members who attended a retreat in September 2000. They also gave us a list of 33 residents who reportedly attended the White House Community Empowerment Conference, Community Grant Workshops, and Board retreat. However, officials could not provide certificates of completion, training agendas or other documentation that would support the claim that sixty residents were properly trained.

Tuition Voucher Fund. Although this activity had six outputs listed in the 2001 Annual Progress Report, the City failed to report the progress on three of the six outputs. For the other three outputs the City correctly reported that it had made no progress. These outputs included major Empowerment Zone tasks such as providing job training programs and placing residents in jobs. Officials informed us that they did not make any progress on this activity because the Business Development Manager who handles the program was not hired until July 2001.

Empowerment 2010 Works. The City could not provide adequate support for four of the nine reported outputs for this activity. Officials reported that the number of:

- Zone resident trainees placed in jobs was reported as 43. Officials could only provide a list of 34 trainees they believed had been placed in jobs.
- Job fairs was reported as four but officials could only support two. Officials told us that only two job fairs were held but they mistakenly added two more projected job fairs when they reported in FY 2001.
- Residents attending job fairs was reported as 256 but officials could only support 157. Officials acknowledged that they could only support 157. They stated that an additional 99 residents were mistakenly reported.
- Residents placed in jobs as a result of job fairs was reported as 67. However, officials provided us a list of only 39 residents they believed were directly placed in jobs.

New Electrical Substation In Support of HOPE VI.

Although this activity had seven outputs listed in the 2001 Annual Progress Report, the City failed to report the progress on four of the seven outputs. The City failed to report its progress on the following programs: 1) Streetscape Improvement 2) Transportation Programs 3) Parks and Playgrounds 4) New and Rehabilitated Facilities. For the other three outputs the City correctly reported its progress.

City Overstated Amount of Leveraged Funding

The City overstated the amount of leveraged funding in its 2001 Annual Progress Report to HUD by about \$6.5 million. Since the amount of leverage funding is an important indicator of the Empowerment Zone's success, the inaccurate information presented a false impression of the program's benefits. The City reported it would receive leveraged funding from various sources totaling about \$20.7 million to support three activities. However, as shown by the table below officials could only provide support for \$14.2 million.

Activity	Supported	Not Supported	Total Reported
Tower Mall	\$13,912,875	\$6,450,000	\$ 20,362,875
New Electrical Substation	\$ 97,000	\$1,000	\$ 98,000
Small Business Resource Center	\$ 160,000	\$ 70,000	\$ 230,000
Total	\$ 14, 169,875	\$6,521,000	\$20,690,875

Tower Mall. A major reason for the shortfall in leveraged funding was because one of the major stores scheduled to locate at the Tower Mall was expected to invest \$12 million, but officials could only support an investment of \$2.75 million. This left a funding shortfall of \$9.25 million. However, the City of Portsmouth partially offset this shortfall by investing \$2.8 million more for the Tower Mall project than was reported to HUD. This ultimately leaves an unsupported leveraged funding total of \$6.45 million for the Tower Mall.

Small Business Resource Center and One Stop Capital Shop. This activity was reported to be receiving \$230,000 of

Improvements In
Reporting Achievements
Are Needed

in-kind services or donations. The in-kind services or donations were expected to come from the Small Business Administration (\$150,000) and Norfolk State University (\$80,000). Officials could not provide support for \$70,000 of the expected in-kind contributions from the Small Business Administration.

Empowerment 2010 officials informed us that they believed that they accurately reported the achievements of the Empowerment Zone. They stated that the data reported each year is accurate to the extent possible, recognizing that multiple data sources were used that involve different methods of collecting, filing, retrieving, and compiling information. They stated that their challenge is to develop and implement a consistent database that will improve data collection, management, and reporting from internal and external sources.

We agree that Empowerment 2010 officials need to develop and implement a consistent database that will improve data collection, management, and reporting from internal and external sources. We disagree however, that officials accurately reported the Zone's accomplishments and milestones. As shown by our audit, the City reported many of its key milestones, outputs and funding inaccurately for the activities it reported to HUD in its 2001 Annual Progress Report. Our audit showed that these conditions occurred because responsible officials did not:

- Develop a formal reporting policy to ensure accurate reporting of the Empowerment Zone Activities to HUD.
- Verify the validity of the supporting information before entering data into the performance measurement system.
- Have a centralized database system to ensure supporting data was complete and readily available.
- Have adequate staff for updating activity status.

As a result, the City has created the impression that the benefits of the City's Empowerment Zone Program were greater than those actually achieved.

Auditee Comments

The City agreed to our recommended corrective actions. It agreed to develop and maintain a formal reporting policy and a centralized database system to ensure that complete information is readily available and maintained. It further agreed to update the status and progress of all activities incorrectly reported and to ensure adequate staff are assigned and trained on HUD reporting requirements.

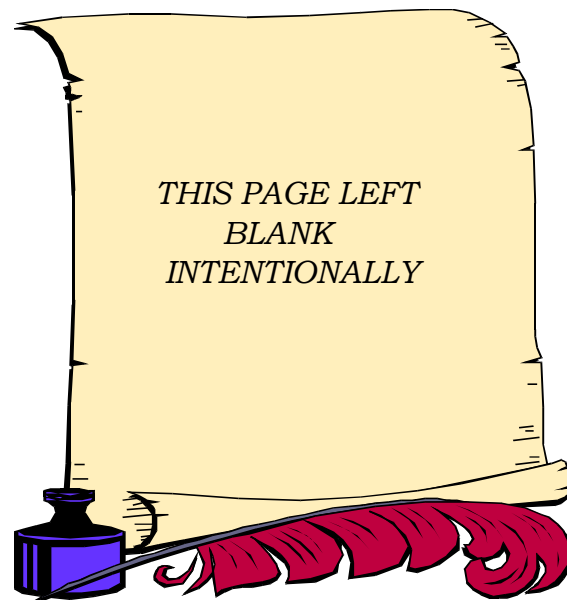
**OIG Evaluation of
Auditee Comments**

If the City fully implements our recommended actions, the integrity of the Program will be strengthened and ensure Program funds are used more effectively and efficiently.

Recommendations

We recommend HUD require the City to:

- 2A. Develop and maintain a formal reporting policy to ensure correct reporting of the Zone's milestones, outputs and funding to HUD.
- 2B. Develop and maintain a centralized database system to ensure complete information is readily available and maintained.
- 2C. Update the status and progress of all activities incorrectly reported to reflect the actual milestones, outputs and leveraged funding of those activities affected.
- 2D. Ensure adequate staff are assigned and trained on HUD reporting requirements.



Management Controls

In planning and performing our audit, we considered the management controls of the Empowerment 2010, Incorporated in order to determine our auditing procedures, not to provide assurance on the controls. Management controls include the plan of organization, methods and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the system for measuring, reporting, and monitoring program performance.

Relevant Management Controls Assessed

We determined the following management controls were relevant to our audit objectives:

- Program Operations- Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Validity and Reliability of Data- Policies and procedures that management has implemented to reasonable ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Compliance with Laws and Regulations- Policies and procedures that management has implemented to reasonably ensure the resource use is consistent with laws and regulations.
- Safeguarding Resources- Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against loss, waste, and misuse.

For each of these activities, we assessed the risk, control environment, control activities, and internal monitoring and reporting functions. We made our assessment and gained our understanding through a testing of transactions in each of the activities.

Significant Weaknesses Found

A significant weakness exists if management controls do not give reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet an organizations objectives.

Based on our review, we believe the following items are significant weaknesses:

- Program Operations.

The City did not establish and maintain formal policy and procedures to ensure (1) funds would be awarded and used according to requirements; (2) establish and maintain an indirect cost allocation for allocating costs that benefit several activities; and, (3) maintain and use federal cost guidelines to ensure costs of the activities met the federal requirements (see finding 1).

- Validity and Reliability of Data.

The City did not properly allocate costs totaling \$249,342 among the different Zone activities that benefit from them (see finding 1). Also, the City incorrectly reported the actual status, leveraged funding and progress in its June 30, 2001 Annual Progress Report to HUD (see Finding 2).

- Compliance with Laws and Regulations.

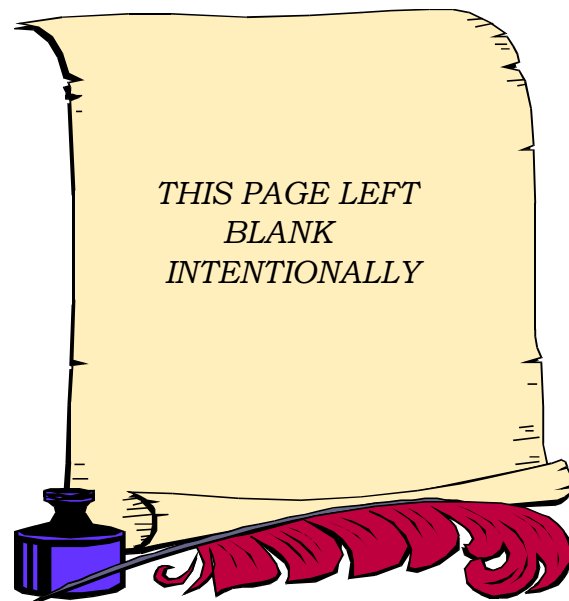
The City obtained \$293,772 of Empowerment Zone funds for three activities that were outside the scope of HUD approved implementation plans. Also, the City paid \$100,332 for items that were either unallowable or unsupported (see Finding 1).

- Safeguarding Resources.

The City paid \$100,332 for items or services that were either unallowable or unsupported. Also, the City obtained \$293,772 of Empowerment Zone funds for three activities outside the scope of HUD approved implementation plans (see finding 1).

Follow Up On Prior Audits

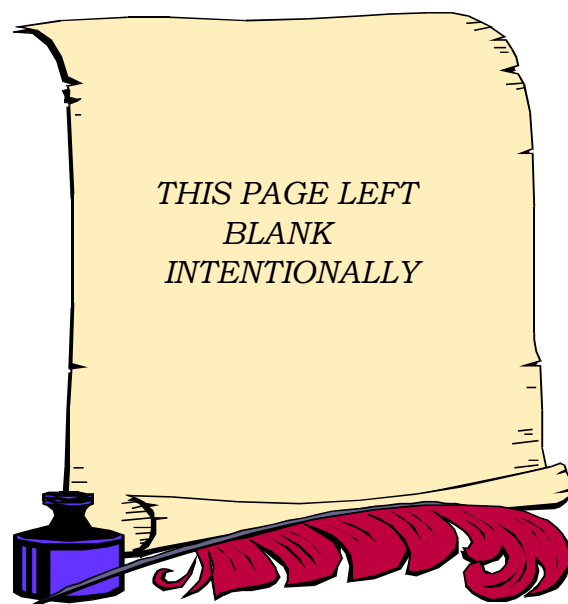
This is the first audit of the joint empowerment zone program of the cities of Norfolk and Portsmouth, Virginia by HUD's Office of Inspector General. The latest single audit for the City covered the fiscal year ended December 30, 2001. The report did not contain finding relevant to the Empowerment Zone Program.



Schedule of Questioned Costs

Recommendation Number	Ineligible 1/	Unsupported 2/
1A	\$231,822	
1B	\$ 26,291	
1C		\$ 74,041
TOTAL	\$258,113	\$ 74,041

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law, contract or Federal, State or local policies or regulations.
- 2/ Unsupported costs are costs charged to a HUD-financed or HUD-insured program or activity and eligibility cannot be determined at the time of audit. The costs are not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the costs. Unsupported costs require a future decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.



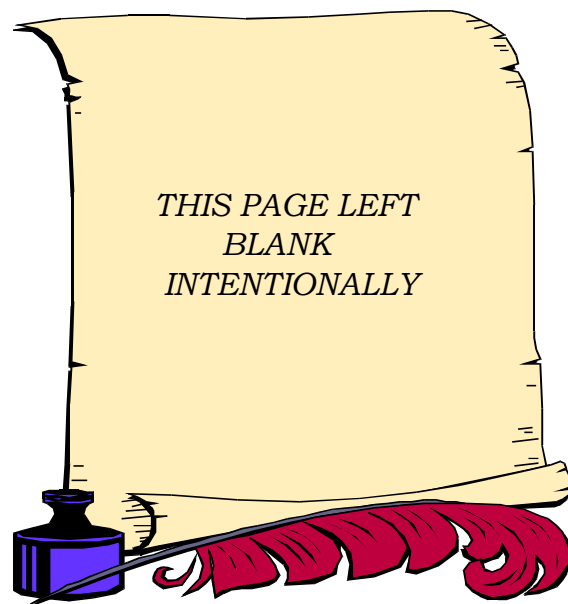
Schedule of Activities Reviewed

Activity	Budgeted Amount	EZ Funds Disbursed As of 6/30/02	Amount Reviewed
1. Formation and Administration Of Empowerment 2010 Corporation *	\$1,928,043	\$ 1,171,342	\$ 568,457
2. Mobile Empowerment Center	\$ 150,120	\$ 80,050	\$ 62,463
3. Empowerment Center/Portsmouth	\$ 467,600	\$ 1,198	\$ -
4. Empowerment 2010 Works *	\$ 5,557,178	\$ 2,696,841	\$ 1,981,601
5. Access to Jobs	\$ 163,000	\$ 128,178	\$ 23,851
6. College Bound Scholarship	\$ 200,000	\$ 200,000	\$ 200,000
7. Child Care Programs –Norfolk ¹	\$ -	\$ 176,977	\$ 37,742
8. Second Chances Program/Portsmouth ^{1 2}	\$ -	\$ -	\$ 52,270
9. Training Stipends	\$ 674,032	\$ 41,429	\$ 2,261
10. MEDAL Loan Loss Reserve	\$ 100,000	\$ 100,000	\$ 100,000
11. Empowerment 2010 Small Business Resource Center*	\$ 363,000	\$ 424,950	\$ 171,028
12. Tower Mall*	\$ 4,100,000	\$ 4,100,000	\$ 4,100,000
13. Park Place East @Broadway	\$ 396,000	\$ 199,400	\$ 199,400
14. Central Brambleton Conservation Project	\$ 330,000	\$ 330,000	\$ 330,000
15. New Electrical Substation In Support OfHOPE VI*	\$ 231,000	\$ 198,344	\$ 196,195
16. Anne/ Outten Street Development	\$ 400,000	\$ 252,733	\$ 247,739
17. Brewery Site Development	\$ 305,000	\$ 305,000	\$ 305,000
18. Norfolk EZ/HOPE VI Community and Supportive Services	\$ 600,625	\$ 112,427	\$ 105,687
19. Neighborhood Development	\$ 127,323	\$ 35,980	\$ -
20. Administrative Office and Empowerment Center/Norfolk	\$ 735,649	\$ 287,492	\$ 190,801
21. Tuition Voucher Funds*	\$ 66,000	\$ -	\$ -
TOTAL	\$ 16,894,570	\$10,842,341	\$ 8,874,495

* This activity was one of the six activities reported in the June 30, 2001 Annual Progress Report

¹ This activity did not have an approved budget at the time of our review. However, it was funded by the Empowerment 2010 Works activity.

² The disbursements from this activity were accounted for in the financial records of the Empowerment 2010 Works Activity.

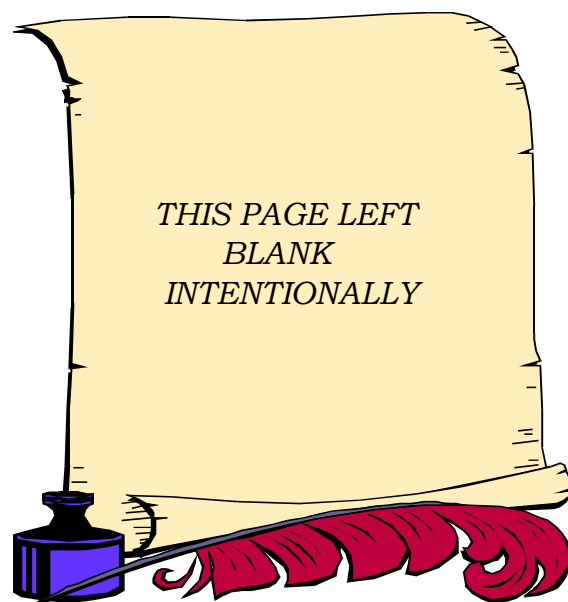


Schedule of Activity Deficiencies

This appendix shows the twenty-one activities that were reviewed with the noted deficiencies by related finding(s).

Activity	Funds Disbursed Without Approved Plan Or Budget	Unsupported/ Unallowable Costs	Unallocated Costs	Inaccurately Reported
	(Finding 1)	(Finding 1)	(Finding 1)	(Finding 2)
1. Formation and Administration Of Empowerment 2010 Corporation *		X	X	X
2. Mobile Empowerment Center				
3. Empowerment Center/Portsmouth				
4. Empowerment 2010 Works *		X		X
5. Access to Jobs				
6. College Bound Scholarship				
7. Child Care Programs –Norfolk	X			
8. Second Chances/Portsmouth	X			
9. Training Stipends				
10. MEDAL Loan Loss Reserve				
11. Empowerment 2010 Small Business Resource Center*	X	X		X
12. Tower Mall*				X
13. Park Place East @Broadway				
14. Central Brambleton Conservation Project				
15. New Electrical Substation In Support Of HOPE VI*				X
16. Anne/ Outten Street Development				
17. Brewery Site Development				
18. Norfolk EZ/HOPE VI Community And Supportive Services		X		
19. Neighborhood Development				
20. Administrative Office and Empowerment Center/Norfolk		X	X	
21. Tuition Voucher Funds*				X
TOTAL	3	5	2	6

* This was one of only six activities that were reported in the June 30, 2001 Annual Progress Report.



Auditee Comments



December 16, 2002

Mr. Daniel G. Temme
Regional Inspector General for Audit
U.S. Department of Housing & Urban Development
Wanamaker Building, Suite 1005
100 Penn Square East
Philadelphia, PA 19107-3380

Dear Mr. Temme:

The enclosed correspondence is in response to your draft audit report on the Norfolk/Portsmouth Empowerment Zone Program dated December 9, 2002.

Empowerment 2010, Inc. sincerely appreciates the assistance provided by the audit in identifying opportunities for improving the administration and management of programs in the Norfolk/Portsmouth Empowerment Zone. While it is our intention to act upon all final recommendations made, there are several corrective actions recommended in the draft audit report with which we disagree. The enclosed correspondence addresses those points of disagreement and recommends alternative corrective measures.

Once again, on behalf of the Executive Team for Empowerment 2010, Inc. I thank you and your auditing team for the thorough and professional manner in which the audit was conducted. The Norfolk/Portsmouth Empowerment Zone program and most importantly, the residents and businesses located in the Zone, will truly benefit from this effort.

Sincerely,

Dr. Landis D. Faulcon
Executive Director

Enclosures

Empowerment 2010, Inc.
2539 Corprew Avenue • 3rd Floor • Norfolk, Virginia 23504 • (757) 314-4228 • Fax: (757) 314-4242

**Empowerment 2010, Inc.
Response to:**

**U.S. Department of Housing and Urban Development Inspector General
Draft Audit Report
on the
Norfolk/Portsmouth Empowerment Zone Program
Dated: December 9, 2002**

Executive Summary

As a result of the review conducted on the Norfolk/Portsmouth Empowerment Zone program the Inspector General for the U.S. Department of Housing and Urban Development (HUD-IG) has made the findings and recommendations stated below. Empowerment 2010, Inc. (E2010) comments and proposed alternative corrective actions are summarized in italics following each recommendation and are detailed in subsequent sections of this response.

Finding 1: The City (Cities of Norfolk and Portsmouth) did not always maintain adequate oversight over its Empowerment Zone funds for all activities.

Recommendations that HUD direct the City of Norfolk to:

1A. Submit separate implementation plans for the Child Care and the Second Chances Programs to HUD for review and approval. If implementation plans cannot be submitted and approved by HUD then reimburse the Empowerment Zone Program \$231,822 from non-federal funds for the amounts that cannot be supported.

E2010 Comment: *According to the HUD document Elements of Implementation Plans dated June 6, 2000, "all EZ/EC programs and projects require an implementation plan." Also refer to the EZ/EC Training and Reference Guided dated July 8, 199, page 30, which contains similar language regarding all "programs/projects requiring and implementation plan." Empowerment 2010 Works is the workforce development program of Empowerment 2010, Inc. An implementation plan was submitted and approved for this program (Empowerment 2010 Works) that includes childcare support and Second Chances. Funding for the workforce development program has been drawdown from the implementation plan approved by the Governance Board and HUD. Empowerment 2010 Works connects Empowerment Zone residents with training and employment. Childcare is available as part of the Empowerment 2010 Works program. Second Chances provides special attention to nonviolent ex-offenders who are participating in the Empowerment 2010 Works program. Expenditures for childcare and*

Second Chances have been included in the Empowerment 2010 Works Implementation plan. This plan is intended to result in Empowerment Zone residents completing training and gaining employment.

As recommended, Empowerment 2010, Inc. will create separate implementation plans for childcare and Second Chances in order to identify specific outputs for each of these workforce development program components. It should be noted however, that both childcare and Second Chances are not separate programs. They are components of Empowerment 2010 Works; the workforce development program for the Norfolk/Portsmouth Empowerment Zone.

- 1B. Reimburse the Empowerment Zone Program \$26,292 from non-Federal funds for unallowable costs paid for meals and gifts unless the City can provide additional documentation to resolve the cited deficiencies.

***E2010 Comment:** Empowerment 2010, Inc. contends that \$19,979.01 of the \$20,284.26 expended for "meals", was for professional activities as referenced in the OMB Circular A-87, Attachment B, Section 30 (c), and are therefore allowable.*

The HUD draft report makes reference to policy in the OMB Circular A-87, Attachment B, Section 18 that states "Costs of entertainment, including amusement, diversion, and social activities and any costs directly associated with such costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities) are unallowable. The costs expended by Empowerment 2010, Inc. for "meals" were not for any of the activities described in Section 18 of the OMB Circular A-87. Empowerment 2010, Inc. provided "meals" for professional activities convened to disseminate technical information related to Empowerment 2010, Inc., professional programs and services provided by Empowerment 2010, and/or the Norfolk/Portsmouth Empowerment Zone. The professional activities consisted primarily of meetings of the Governance Board and its committees, the Citizens Advisory Board, Job Fairs, and employment assessments. According to OMB Circular A-87, Attachment B, Section 30 (c), "Costs of meetings and conferences where the primary purpose is the dissemination of technical information, including meals, transportation, rental of meeting facilities, and other incidental costs are allowable."

Regarding costs expended for memorabilia (promotional items), it is unfortunate that guidance provided by HUD at the HUD Round II Empowerment Zone Implementation Conference, in Washington, D.C., March 10-12, 1999, conflicts with OMB Circular A-87, Attachment B, Section 2 (e)(3). The documentation provided by HUD on the section entitled "Getting The Message Out: Effective Media and Marketing

Communications”, clearly suggests the appropriateness of using promotional items such as paperweights, mugs, memo pads, etc. A copy of the applicable pages of the documentation provided by HUD is enclosed. Also note that the types of materials are fundamental to our ability to market and execute community outreach activities.

E2010 Proposed Alternative Action: *Cite those costs for memorabilia (\$6,007) and for meals other than professional activities (\$305.25) as costs that could have been used more effectively. However, given the relatively limited nature of those costs, recommend that HUD direct the City of Norfolk to cease paying for any future costs for memorabilia and meals for non-professional activities using Federal funds.*

1C. Provide documentation to justify unsupported costs of \$95,013 paid from Empowerment 2010 Works (\$1,620); Formation and Administration of Empowerment 2010 Corporation (\$53,393); Administrative Office and Empowerment Center/Norfolk (\$25,000); and Norfolk EZ/HOPEVI Community and Supportive Services (\$15,000). If adequate documentation cannot be provided, reimburse from non-Federal funds for the amounts that cannot be supported.

E2010 Comment: *A summary of the documentation submitted to justify those costs cited as unsupported has been included in a subsequent section of this response.*

1D. Develop and use an indirect cost plan to allocate indirect costs and ensure that the \$249,372 costs our audit identified as not properly allocated are properly allocated.

E2010 Comment: *Empowerment 2010, Inc. will develop and use an indirect cost plan as recommended.*

1E. Cease paying for the costs of meals, gifts and contributions specifically prohibited by OMB Circular A-87.

E2010 Comment: *If OMB Circular A-87, Attachment B, Section 30 (c) is not applicable Empowerment 2010, Inc. shall cease paying for the costs of meals, gifts and contributions specifically prohibited by OMB Circular A-87 as appropriate.*

Finding 2: The City inaccurately reported accomplishments to HUD.

Recommendations that HUD direct the City of Norfolk to:

2A. Develop and maintain a formal reporting policy to ensure correct reporting of the Zone’s milestones, outputs and funding to HUD.

3

E2010 Comment: The Norfolk/Portsmouth Empowerment Zone has achieved measurable progress and results in accomplishing its goals. The Empowerment Zone has reported its progress using multiple data sources; primary source documents, internal files, participant data, reports from service providers, etc. The data has been accurately reported according to source documents. Several residents are receiving multiple services. In some instances, residents have been counted more than once because of their participation in various activities. This will be corrected with the implementation of a consistent database and participant tracking system. This will improve both organizational and staff efficiencies in data management and reporting.

Empowerment 2010, Inc. will develop and maintain a formal reporting policy as recommended.

2B. Develop and maintain a centralized database system to ensure complete information is readily available and maintained.

E2010 Comment: Empowerment 2010, Inc. will develop and maintain a centralized database as recommended.

2C. Update the status and progress of all activities incorrectly reported to reflect the actual milestones, outputs and leveraged funding of those activities affected.

E2010 Comment: Empowerment 2010, Inc. will update the status and progress of all activities incorrectly reported.

2D. Ensure adequate staff is assigned and trained to ensure reporting to HUD is accurate.

E2010 Comment: Empowerment 2010, Inc. will ensure adequate staff is assigned and trained to ensure accurate reporting to HUD.

Details Regarding HUD Recommendation 1B

1. Commentary. The draft audit report states, “We acknowledge that in limited instances the cost of meals may be allowable. OMB Circular A-87 does in fact state that meals provided at meetings where the primary purpose is the dissemination of technical information are allowable. But, we found that catered food was provided at meeting where the primary purpose was not the dissemination of technical information.”

Empowerment 2010, Inc. contends that the majority of the costs expended for meals were for the meetings where the primary purpose for the meetings was in fact, the dissemination of *technical* information. The draft audit report also seems to focus on the issue of food being “catered”, which can give an inaccurate perception. While it is unclear if this perception contributed to the conclusion arrived at by the auditors, it should be noted that for virtually all of the activities food was provided by businesses that provide “catering services”. However, the extent of the “catering” function was the delivery and set up of the food, and not the catering or serving of that food to meeting participants.

The following table provides a summary of the categories of activities and associated costs identified during the audit, wherein costs for “meals” were expended. Following the table is a description of the purpose for each of the listed activities.

Professional Activities	Cost
Governance Board Meetings	\$6452.80
Business Development Meeting	\$77.67
Empowerment Center Committee Meetings	\$92.97
Workforce Development Committee Meetings	\$141.67
Citizens Advisory Board Meetings/Retreat	\$3235.96
Executive Team Meeting	\$169.12
RFP Review Committees	\$262.58
Assessments	\$2967.27
Career Celebrations (Job Fairs)	\$2629.66
Training Fairs/Seminars	\$911.93
Business Development Open House	\$1596.95
Grand Opening	\$632.49
Director Interview	\$102.56
Interviews	\$705.38
Sub-total:	\$19979.01
Other Activities	Cost
End of Year Celebration	\$305.25
Sub-total:	\$305.25
Total:	\$20284.26

- a. Governance Board Meetings. Per the approved Bylaws of Empowerment 2010, Inc., "The business and affairs of the Corporation shall be managed by a Board of Directors or not less than eighteen (18) nor more than thirty-four (34) directors." The Governance Board typically meets once each month to receive and consider *technical* information provided by the staff of Empowerment 2010, Inc. regarding the Corporation and to communicate decisions regarding how the Corporation shall be managed. Representative topics of discussions at these meetings have included discussions regarding the procedures for handling and approving implementation plans, procedures for administering and approving requests for proposals, the review and approval of budgets, just to name a few.

Governance Board members are all volunteers, many of whom work during the day. Therefore, board meetings usually take place between the hours of 5:00 p.m. to 7:00 p.m. Food is provided at these meetings because the members often have to come to these meetings directly from their place of employment.

- b. Governance Board Committee Meetings. Per the approved Bylaws of Empowerment 2010, Inc., "The Board of Directors may also establish such other standing or special committees as a majority of the Board of Directors may deem necessary and appropriate for the conduct of the business of the Corporation." In this regard the Governance Board has established committees to manage the business conducted in the Business Development, Workforce Development, Empowerment Centers and Neighborhood Development divisions. Each committee typically meets once each month to receive and consider *technical* information provided by the staff of Empowerment 2010, Inc. regarding the activities of the division over which the committee has been given charge and to communicate decisions regarding how the division shall be managed.

Governance Board Committee members are all volunteers, many of whom work during the day. Therefore, committee meetings often take place outside of normal working hours or during the lunch hour. Food is provided at these meetings because the members often have to come to these meetings directly from their place of employment.

- c. Citizens Advisory Board Meetings. Per the approved Bylaws of Empowerment 2010, Inc., "A Citizens Advisory Board shall be appointed by the Board of Directors to serve in an advisory capacity to the Board of Directors...". In order for the Citizen Advisory Board (CAB) to provide informed advice to the Board of Directors (Governance Board) *technical* information regarding Empowerment 2010 programs must first be disseminated to CAB members. The dissemination of that *technical* information takes place at CAB meetings and retreats. Representative information disseminated has included procedures for handling

implementation plans, procedures for administering requests for proposals, and the review of draft budgets, just to name a few.

CAB members are all volunteers, many of whom work during the day. Therefore, CAB meetings are typically scheduled in the early evening between 5:00 p.m. and 8:00 p.m. or on Saturdays. Food is provided at these meetings because the members often have to come to these meetings directly from their place of employment.

- d. Executive Team Meeting. The Empowerment 2010, Inc. Executive Team consists of the Executive and Deputy Executive Directors, the Finance Officer, the Executive Assistant and the four managers for the organization. To develop strategies and recommendations regarding Empowerment Zone programs the Executive Team meets periodically for half-day to full day working sessions. Typical *technical* information disseminated and discussed at these planning sessions includes information regarding organizational goals and objectives, organizational procedures and processes, and funding and budgets.

When, in the interest of time and efficiency, it is believed advantageous to conduct these planning sessions through lunch, food is on occasion purchased for consumption during the working session.

- e. Request for Proposal (RFP) Review Committees. Since incorporation Empowerment 2010, Inc. has issued a variety of RFP's for services required either for or in support of Empowerment Zone programs. Representative topics for RFP's include job training, assessments, transportation, architectural services, construction services, and marketing services. A committee that typically consists of subject matter experts is formed for each of the RFP's to review the *technical* information provided in the respective proposals and to make informed recommendations to the Governance Board.

The review process typically takes three to four hours. All committee members are volunteers, many of whom work during the day. Therefore, meetings are typically scheduled during lunch to minimize the time committee members have to be away from their offices. Food is provided at these meetings as a working lunch while the proposals are reviewed.

- f. Assessments. The assessment process is an evaluative one that consists of a series of eight tests designed to identify strengths, support services needs, occupational skills, employment barriers, individual capabilities, vocational potential, educational proficiencies and life goals. The purpose of this comprehensive assessment is to maximize the success of program participants by connecting them with the resources and services needed to meet the requirements of training, education and employment opportunities. Empowerment 2010, Inc. has contracted the NOAH Group to provide

assessment services that include an evaluation of the resident's psychological and emotional functioning, academic skill sets, career aptitude, training and employment reliability, Individual Employment Plan development, employment readiness training and interpretation of test and supportive services.

The aforementioned testing requires approximately 4 to 5 hours of each participant's time to administer and review. Food has been provided at assessments because of the length of time involved during which *technical* information is exchanged.

- g. Career Celebrations, Training Fairs/Seminars. "Career Celebration" is the name Empowerment 2010 has given to the job fairs held to facilitate the dissemination of *technical* information directly to Empowerment Zone residents regarding employment and job training opportunities available at that time. A typical Career Celebration includes 20 to 30 businesses, recruiters and employment specialists all congregated at a single location for six to eight hours to disseminate *technical* information to participants (visiting Empowerment Zone residents). Given that the Career Celebrations last the better part of the day, food is provided at the activities in an effort to provide a small degree of sustenance for presenters as well as participants whose presence is sought without significant breaks in time for full meals.
 - h. Grand Opening and Business Development Open House. The Small Business Resource Center and One Stop Capital Shop (SBRC/OSCS) was created to assist small businesses within the Empowerment Zone. Support services are provided to businesses by Empowerment 2010 staff and a full complement of service partners located at the SBRC/OSCS and includes business management, business technology, marketing, risk management, real estate and legal consultation. The purpose for the Grand Opening and Business Development Open House activities are to disseminate *technical* information regarding the nature of services available to Empowerment Zone businesses and to encourage the use of the facility.
- The aforementioned activities typically span the better part of a day and therefore food is provided at these functions as a courtesy and encouragement to presenters as well as participants.
- i. Director Interview and Interviews. The interview activity referenced for which food was provided was in support of the search conducted to identify candidates to fill the Executive Director position for Empowerment 2010, Inc. The interview process was lengthy and the participants were volunteers who often worked through lunch during the process. The information disseminated during the interviews concerned *technical* matters related to programs and the organization structure of Empowerment 2010, Inc.

- j. End of Year Celebration. The End of Year Celebration was the only activity for which funds were expended to pay for meals for the staff of Empowerment 2010, Inc. where the primary purpose for the meeting was not the dissemination of technical information.
2. Documentation regarding how funds were used for the various activities listed above is quite extensive and was provided during the course of the audit. Therefore only representative copies of documents provided previously have been regenerated for inclusion with this response.

Details Regarding HUD Recommendation 1C

1. Commentary. The draft audit report stated the need for documentation to justify unsupported costs of \$95,013 paid for Empowerment 2010 Works (\$1,620); Formation and Administration of Empowerment 2010 Corporation (\$53,393); Administrative Office and Empowerment Center/Norfolk (\$25,000); and Norfolk EZ/HOPEVI Community and Supportive Services (\$15,000). The following comments provide a summary of the supportive documentation that is enclosed with this response.

- a. Empowerment 2010 Works (\$1,620).

Check #1027, dated 9/26/00, in the amount of \$1,620, is the check referenced concerning this expenditure. The documentation enclosed with this response includes the invoice for \$1,620, from STOP organization dated September 9, 2000, and signed contracts for the eight participants referenced in the invoice.

- b. Formation and Administration of Empowerment 2010 Corp. (\$53,393).

The \$53,393 is represented by four checks of \$4,631.18, \$19,351.81, \$11,559.99, and \$17,849.52.

Check #1014, dated 9/15/00, in the amount of \$4,631.18, covers an invoice for services provided by Commercial First Appraiser. The check was paid by Empowerment 2010 attorneys Cooper, Spong & Davis, through the Portsmouth Redevelopment and Housing Authority (PRHA), in the amount of **\$875.00**. The balance of **\$3,756.18** was for invoices from Dave Iwans Associates (DIA), a marketing and public relations firm that PRHA hired for work done for the Portsmouth/Norfolk empowerment zone. A copy of the supportive documentation is enclosed.

Check #1090, dated 9/26/00, in the amount of \$19,351.81, was for rent paid for the former location of the Empowerment 2010, Inc. staff at 201 Granby Street, Norfolk, Virginia. Enclosed is a document that refers to the charges issued by the Norfolk Redevelopment and Housing Authority (NRHA). The enclosed "inter-office communication" to Eleanor Bradshaw, Director of the Norfolk Works organization was provided to show the annually rent for the office space. As discussed in the exit meeting, Empowerment 2010, Inc. took over the 201 Granby Street office space and assumed the lease that was used by the former Norfolk Works organization. The documentation shows that the \$19,351.81 represents nine months of rent @\$2,300.83 per month, less \$1,175.66 paid previously. $(2,300.83 \times 9 = \$20,707.47 - \$1,175.66 = \$19,351.81)$

Check #2082, dated 8/4/01, in the amount of \$11,559.99, paid for the pro-rata

calculation for support services provided to Empowerment 2010 by the NRHA, as agreed in a Financial Services Agreement. As noted on the check, this amount included an adjustment from previous charges. A copy of the supportive documentation is enclosed.

Check #2182, dated 10/8/01, in the amount of \$17,849.52, paid for the pro-rata calculation for support services provided to Empowerment 2010 by the NRHA, as agreed in a Financial Services Agreement. The enclosed documentation includes a copy of check #2182 and NRHA's billing statement. The billing statement reflects a charge of \$17,849.52. Per the NRHA/Empowerment 2010 agreement and as reflected on the statement of costs, the monthly charge is \$19,303, for financial, human resources and information systems support. An additional \$278 is included in the amount billed for liability insurance. The invoice in question reflects adjustments made by NRHA that reduced the monthly charge.

- c. Administrative Office and Empowerment Center/Norfolk (\$25,000) and Norfolk EZ/Hope VI Community and Supportive Services (\$15,000)

The auditor reported "Specifically, the City said it paid \$25,000 to a property owner to help renovate the office space for the Empowerment 2010 administrative offices in Norfolk in exchange for a lower monthly rent. However, the City could not provide adequate documentation to support the claim that they received a lower monthly rent." Likewise, the auditor reported "Specifically, the City said it paid \$15,000 to a property owner to renovate the office space for offices in HOPE VI Community and Supportive Services Norfolk in exchange for a lower monthly rent. However, the City could not provide adequate documentation to support the claim that they received a lower monthly rent."

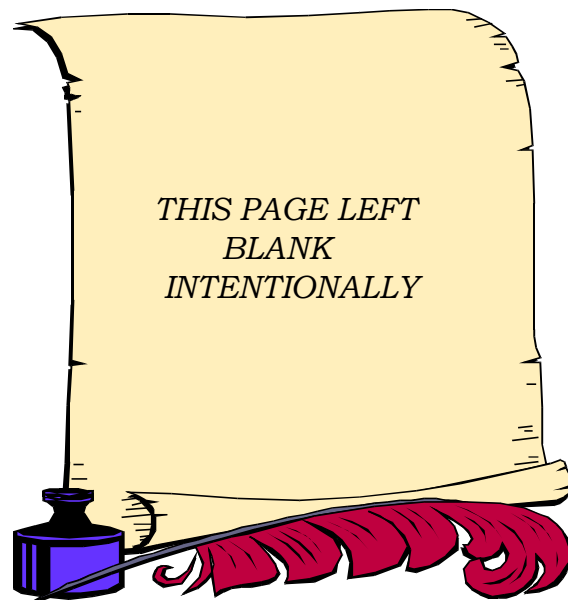
The lease agreements for both of the referenced facilities were written after lengthy negotiations with the landlord regarding the lease, during which rent, utility costs, and renovations were all discussed. As a result of the negotiations the landlord agreed to convert the former hospital space to office use at a lease rate of \$12 per square foot, to include all utilities, with the advance contribution of \$25,000 and \$15,000 respectfully. As stated in the lease, Empowerment 2010 "...will contribute \$25,000 (\$15,000 HOPE VI), towards the cost of renovations at the time of execution of this lease." Empowerment 2010, Inc. contents that the operative phrase, as stated in the lease, is "...towards the cost of renovations at the time of execution of this lease", and not the content of discussions that took place during the negotiations for which only the signed lease agreement itself can serve to document.

To accomplish this end, the landlord was required to demolish and renovated the existing interior of the space per specifications provided by Empowerment

2010, Inc. As a point of reference for the quality of renovation and build-out sought the lease further states that the landlord shall cause the renovation to be equal or better than the standards for construction, quality, carpet and etc, as the Small Business Resource Center/One Stop Capital Shop located at 1130 Tabb Street, Norfolk, Virginia.

Contributions made toward the cost for building out space is by no means an unusual practice, particularly if the overall cost is reasonable. The dollars Empowerment 2010, Inc. contributed towards the cost for renovations was a very small percentage of the total cost for the renovations. Per the letter enclosed from the landlord dated December 6, 2002, the total cost to build-out the space for Empowerment 2010, Inc. was \$210,000. Based upon usable square footage occupied by Empowerment 2010, Inc. (9,339 square feet), the pro-rata cost per square foot should be \$16.50 ($\$210,000/5$ year lease + 112,068 per year @ \$12 per square foot = \$154,068 per year; $\$154,068/9,339$ square feet = \$16.50 per square foot). The \$12.00 per square foot cost reflected in the lease clearly indicates that Empowerment 2010, Inc. received a lower monthly lease as a result of contributing \$25,000 (\$15,000 HOPE VI) toward the costs for building renovations.

Enclosed are floor plans depicting the before and after renderings of the property. The drawings clearly show the extensiveness of the build-out work conducted on the lease space.



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